

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

LOUIS V. SCHOOLER and FIRST
FINANCIAL PLANNING
CORPORATION, dba Western
Financial Planning Corporation,

Defendants.

CASE NO. 3:12-cv-2164-GPC-JMA

**NOTICE OF TENTATIVE RULING
ON RECEIVER'S REPORT AND
RECOMMENDATION
REGARDING GENERAL
PARTNERSHIPS**

Before the Court is the issue of whether all, some, or none of the approximately 86 general partnerships ("GPs") currently under receivership should be released from the receivership and under what conditions, if any. The Receiver has filed his Report and Recommendation on this issue. (ECF No. 852.) The parties, (ECF Nos. 874, 880), and the investors, (*see, e.g.*, ECF No. 869), have responded to the Receiver's Report and Recommendation, and included both critiques and counterproposals.

On July 22, 2014, the Court issued its Order on Sua Sponte Reconsideration of August 16, 2013 Order to Release General Partnerships from Receivership (the "Reconsideration Order"). (ECF No. 629.) The Reconsideration Order concluded that the GPs should remain in the receivership and, pursuant to that conclusion, the GPs'

1 due process rights were implicated and thus a hearing should be held. (*Id.* at 7–8.) On
2 October 10 and 15, 2014, a due process hearing was held (the “Investor Hearing”).
3 (ECF Nos. 790, 794.) On October 17, 2014, the Court issued its Order Regarding
4 Investor Hearing (the “Investor Hearing Order”). (ECF No. 808.) The Investor Hearing
5 Order reiterated the Court’s concerns regarding whether it was appropriate to treat all
6 GPs the same in light of their varying financial conditions and thus ordered the
7 Receiver to file a report and recommendation addressing the Court’s concerns. (*Id.* at
8 3–6)

9 Upon review of the Receiver’s Report and Recommendation and the responses
10 thereto, the Court provides notice of its tentative ruling on this issue. While the
11 Reconsideration Order was concerned with the ability of the investors to manage
12 themselves going forward, (ECF No. 629, at 3–7), and the Investor Hearing Order was
13 concerned with the differing financial health of the GPs, (ECF No. 808, at 3), the Court
14 now concludes that a just and fair endgame is the main focus. As such, the appropriate
15 considerations are those of investor restitution and the commingling of Western’s
16 assets with investor assets.

17 Generally, during the pendency of an SEC enforcement action, property related
18 to the allegedly fraudulent investment scheme is held in receivership. *See Sec. and*
19 *Exch. Comm’n v. Small Bus. Capital Corp.*, No. 5:12-cv-3237-EJD, 2013 WL 6701928,
20 at *4 (N.D. Cal. Dec. 19, 2013); *see also In re San Vicente Med. Partners Ltd.*, 962
21 F.2d 1402, 1404–05 (9th Cir. 1992). While Defendants and some investors argue that
22 the general rule should be departed from in this case, the Court disagrees and finds that
23 the receivership should be maintained over all the GPs.

24 In SEC enforcement actions, defendants may be ordered to disgorge their ill-
25 gotten gains. *Sec. and Exch. Comm’n v. First Jersey Sec.*, 101 F.3d 1450, 1474 (2d Cir.
26 1996). These funds can then be then be *pro rata* distributed back to investors, which
27 the SEC has indicated it intends to seek. (*See* ECF No. 880.) In this case, the SEC has
28 moved for disgorgement, (ECF No. 685), but the hearing on the SEC’s motion will not

1 be held for several months. (ECF No. 849.) Moreover, outside of moving to establish
2 that the GPs are securities, the SEC has not yet moved on its fraud causes of action.
3 (See ECF No. 1.) Whether disgorgement is granted and whether investors were
4 defrauded bear significantly on whether distribution to investors is appropriate. See
5 *Sec. and Exch. Comm'n v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997) (noting
6 that disgorged funds “may often go to compensate securities fraud victims for their
7 losses”). An order on either disgorgement or fraud will take months if decided on
8 summary judgment, and potentially upwards of a year if decided at trial. (See ECF No.
9 850.)

10 Western’s assets include an interest in every GP property except one—Washoe
11 I— and notes from nearly two-thirds of GPs, including two of the GPs who own
12 Washoe I. (See ECF No. 852-1, Ex. A.) If Western is ordered to disgorge its ill-gotten
13 gains, this disgorgement may include its share of each GP property and the GP notes.
14 Though the investors, through their GPs, own the vast majority of the GPs and thus the
15 GP properties, Western has essentially commingled its assets with those of investors
16 by taking an interest in interest in almost every GP and holding notes from nearly two-
17 thirds of GPs. If restitution to investors of Western’s disgorged funds is appropriate,
18 every Western investor would arguably have an interest in every GP property. Were the
19 Court to release the GPs, a GP property would be subject to the control of its several
20 hundred general partner investors who would have no obligation to consider the
21 interests of the thousands of investors who may be able to lay claim to Western’s
22 interest through investor restitution. Continuation of the receivership ensures that the
23 Receiver and the Court maintains oversight of these properties and that any action
24 taken in relation to the GPs or GP properties is the most equitable overall. See *Sec. and*
25 *Exch. Comm’n v. Credit Bancorp, Ltd.*, No. 99-cv-11395-RWS, 2000 WL 1752979, at
26 *13, 43 (S.D.N.Y. Nov. 29, 2000).

27 Though the Court could order Western to divest its interest and the GPs to pay
28 the notes, and thus release the GPs without the aforementioned issue, this too is


1 problematic. Western may not be liable for disgorgement or fraud and altering the
2 structure of the GPs at this stage may be prejudging Western's liability. As the
3 appropriate course of action is significantly influenced by Western's liability, the Court
4 finds it appropriate to wait until these issues are resolved before removing the GPs
5 from the receivership or altering their structure.

6 While the Court believes that continuation of the receivership over all the GPs
7 is appropriate, the Court does have some concerns regarding their current financial
8 status as well as the information available to their investors. As the Receiver has
9 indicated, some investors are not paying their share of costs and these costs are shifted
10 onto other investors who are paying more than their share of costs. (*See* ECF No. 852-
11 1, Ex. C.) Due to comments at the investor hearing, it appears that the operational bills
12 sent to investors lack detail. Thus the Court finds it appropriate to order that additional
13 information be provided to investors so that they can make a choice as to whether to
14 pay the higher operational bill or not. The Receiver shall prepare an information packet
15 for each investor similar to what he prepared when the Court initially ordered that the
16 GPs be released. This packet will include an updated appraisal of their GP's property,
17 the financial health of their GP and their cotenant GPs, details regarding what
18 percentage of investors are paying their operational bills, and facts regarding this case.
19 Additionally, operational bills sent to investors in the future will detail exactly what
20 each investor is being billed for and what may occur if some investors fail to pay their
21 operational bills.

22 At this juncture, it is unclear whether liquidation of some GP properties is
23 appropriate. However, the Receiver's Report and Recommendation appears to indicate
24 that liquidation of GPs that will be unable to pay their bills may be warranted. It may
25 also be the case that billing investors to maintain GP properties is not the wisest course
26 of action based on the valuation of their GP and its property. Thus the Court orders the
27 Receiver to provide a report and recommendation regarding whether the financial
28 health of certain GPs warrants liquidation of certain GP properties. Finally, based on

1 issues with the partnership administrators as well as the savings that could be provided
2 by a professional management company, the Court grants the Receiver's request to
3 transition administration of the GPs to the Lincoln Property Company.

4 DATED: January 22, 2015

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7 HON. GONZALO P. CURIEL
8 United States District Judge
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